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IN THE

Supreme Court of the United States

DIRECTV, INC. and ECHOSTAR SATELLITE L.L.C.,

Petitioners,

– v. –

MARK TREESH, Commissioner for the Department of Revenue for the Commonwealth of Kentucky,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

REPLY BRIEF FOR PETITIONERS

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RULE 29.6 STATEMENT

Petitioners DIRECTV, Inc. and EchoStar Satellite L.L.C. refer to their Rule 29.6 Statements in the Petition for Writ of Certiorari in this matter. DIRECTV amends that statement, to make it current, as follows: News Corporation and its wholly owned subsidiary Fox Entertainment Group have sold their ownership interest in The DIRECTV Group, Inc. to Liberty Media Company, a publicly traded company.

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INTRODUCTION

The most distinctive feature of Kentucky's Brief in Opposition is how little it opposes.

Point I of the Petition asserts that "Kentucky's tax-and-subsidy scheme raises a novel Dormant Commerce Clause issue" that this Court has not resolved. Pet. 11 (capitalization altered). Kentucky does not disagree.

Point II claims that "this case raises issues of national importance." Pet. 18 (capitalization altered). Kentucky offers not a word of opposition.

Point III opens with the assertion that "the Court of Appeals erred in" resolving the question presented, by "distinguishing between two sorts of subsidies—paying cash and covering costs." Pet. 26 (capitalization altered). Kentucky does not defend that holding. Point III then identifies two other mistakes. Pet. 31-36. Kentucky blindly repeats, scarcely defends, or reluctantly accepts all of these errors.

Instead of focusing on defending the decision below, Kentucky directs almost all its energy to a sideshow—an alternative argument in support of the outcome that was neither raised in the Petition nor resolved by the Court of Appeals. The alternative argument is so flawed that it should not dissuade this Court from taking this case to resolve the novel issues of national importance that Petitioners raise. If anything, the opportunity to reject Kentucky's main merits argument should be an added enticement, for it underscores that this Court can clarify how longstanding principles apply to a variety of important new technological markets.

ARGUMENT

I. KENTUCKY DOES NOT DISPUTE THAT THIS CASE RAISES A QUESTION THIS COURT HAS NEVER RESOLVED, AND OFFERS NO DEFENSE OF THE COURT OF APPEALS' RESOLUTION OF THAT QUESTION.

The Petition demonstrates that the lower courts are confused as to which tax devices, and combinations of devices, are impermissibly discriminatory, especially when it comes to tax-and-subsidy schemes. *See* Pet. 11-18. In particular, the Petition shows that this Court has never addressed the combination presented here, involving subsidies in the form of cost abatement, as opposed to subsidies in the form of cash payments. *See* Pet. 16-18. Kentucky does not dispute either the general point or the specific one.

If anything, Kentucky underscores the need for this Court's intervention. The brief passage in the Opposition that focuses on the central question presented tries to distinguish *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), as follows: "The *West Lynn Creamery* case involved the creation of a fund from which subsidies were distributed to in-state [businesses]. In this case, there are no subsidies being paid to in-state businesses." Opp. 18. That is exactly the point of the Petition: Kentucky is not directly paying subsidies to in-state businesses, but is instead achieving the same end by paying a cost on their behalf. The question is whether that makes a difference, as Kentucky claims, and as the Court of Appeals held. This Court has never answered that question, and Kentucky does not say that it has.

What is perhaps most striking about Kentucky's discussion of the merits of the novel question presented is that Kentucky, like the Court of Appeals, does not even try to explain why discriminatory cost abatement *should* be treated any differently than the discriminatory cash subsidy in *West Lynn Creamery*. Kentucky does not dispute that a uniform state tax implicates precisely the same considerations when tied to discriminatory cash payments as when tied to discriminatory cost abatement. *See* Pet. 26-31. Kentucky does not suggest that the two have different economic effects. *See* Pet. 27-29. Nor does Kentucky dispute that it has replicated the same political dynamic that troubled this Court in *West Lynn Creamery*. *See* Pet. 29-30.

In short, in both economic effect and political form, the form of the subsidy is indistinguishable from the one this Court struck in *West Lynn Creamery*. Kentucky disputes none of this.

II. KENTUCKY DOES NOT DISPUTE THAT THIS CASE IMPLICATES ISSUES OF PROFOUND NATIONAL IMPORTANCE.

Kentucky also does not dispute that the stakes in this case are extraordinarily high. First, Kentucky does not dispute that the Court of Appeals' analysis is a roadmap for an end-run around the Dormant Commerce Clause's prohibition against discriminatory taxes and other forms of state economic protectionism. Pet. 18-19. As the National Taxpayers Union has pointed out, "similar schemes can be implemented by any other state and can be used to discriminate in favor of in-state interests in practically any industry." NTU Br. at 20.

Second, Kentucky does not even try to rebut Petitioners' extensive argument that the impact of this case could be especially profound in the market for multi-channel video programming. Kentucky breathes not a word of dissent to Petitioners' arguments that: (1) the entry of satellite TV into the market has had a profound effect on the quality and price of multi-channel television programming; (2) states have strong economic incentives to favor local cable monopolies over satellite; or (3) the gains satellite has made are fragile and could be scuttled if states follow Kentucky's lead by effectively adding a 5% cost on satellite customers, alone. *See* Pet. 19-25; Public Knowledge Br. at 19-21.

Third, both Petitioners and *amici* have underscored the profound ramifications that the Court of Appeals' ruling can have for other industries, particularly industries harnessing new technologies with minimal footprints in any particular state. *See* Pet. 24-25; Public Knowledge Br. at 21-22.

Kentucky does not refute any of these practical consequences.

III. KENTUCKY'S ALTERNATIVE GROUND SUPPORTING THE RESULT BELOW IS MERITLESS AND WILL NOT PREVENT THIS COURT FROM ADDRESSING THE QUESTION PRESENTED.

Kentucky's main argument against certiorari is that the Court of Appeals reached the right result, on an alternative ground: that discrimination against satellite and in favor of cable is not discrimination against interstate commerce. Opp.

10-13, 15-17, 18.

Notably, the basis Kentucky offers for this conclusion is different from anything the Court of Appeals held. The Court of Appeals held that discrimination against satellite did not implicate interstate commerce because cable and satellite are two "distinct" services. App. 16a. As Petitioners have demonstrated, that holding is plainly incorrect, Pet. 31-35—so obviously incorrect that Kentucky does not even try to advance that argument.

Rather, the main thrust of Kentucky's argument is that its law does not discriminate against out-of-state businesses in some of the traditional and blatant ways that have been illegal for well over a century. Thus, for example, Kentucky correctly points out that its law does not explicitly "make any differentiation based upon the location of the provider or the origin or situs of the service," Opp. 2-3; and that "[n]o distinction ... is made between in-state providers and out-of-state providers or the origins of the video programming sold or provided," Opp. 11.

These observations prove only that the protectionist movement has learned lessons from the Nineteenth Century, when this Court invalidated simpler forms of discrimination, such as drummers' laws of the post–Civil War era that discriminated against a salesperson or personal service provider who is just traveling through a state, or import tariffs that, by definition, burden only products from other states. *See, e.g.*, *Welton v. Missouri*, 91 U.S. 275 (1876); *Nippert v. City of Richmond*, 327 U.S. 416 (1946).

But Dormant Commerce Clause jurisprudence did not freeze during Reconstruction. Over the past 30 years in particular, this Court has recognized that state protectionism undermines interstate commerce even if it does not explicitly declare, "out-of-state businesses are unwelcome here" or "out-of-staters must pay higher tariffs." As the Petition explains, a long line of cases, beginning with *Boston Stock Exchange*, stands for the proposition that the Dormant Commerce Clause is not limited to such ham-handed measures. It is every bit as impermissible for a state to favor one business over another, or one transaction over another, because that business or transaction entails more in-state activity. *See Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336 (1977) (higher tax rate for in-state residents' stock transactions completed through out-of-state exchanges); *Maryland v. Louisiana*, 451 U.S. 725, 774-75 (1981) (credit for in-state gas refining against severance tax for in-state gas production); *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 400 (1984) (credit against franchise tax for increasing ratio of exports through in-state ports); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (higher intangibles tax rate for residents' ownership of stock in corporations with out-of-state income); *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564 (1997) (withheld property tax exemption for in-state accommodations servicing out-of-state residents); *see also Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738 (6th Cir. 2004) (income tax credit for locating machinery and equipment in state), *vacated on other grounds*, 547 U.S. 332 (2006).

As these cases recognize, the means by which

discrimination can implicate interstate commerce are as varied as the firms and their goods and services in our modern economy. The manufacture and production of goods, long specialized and mechanized, is being accomplished by ever larger accumulations of capital. The major corporations that generally undertake these activities must choose where to locate the various components of their infrastructure, from corporate offices to manufacturing facilities, and from ports of entry to diversified holdings. Similarly, the delivery of services has moved well beyond personal services and implicates complex industries as fundamental as electricity and as evolving as telecommunications and video. In many of these markets, rapid technological changes and intensive innovation have created new industries and methods of competition. These methods of competing often involve increasingly less intensive investment in infrastructure in a particular state in order to service its residents. They also make it easier for sellers of goods to reach a state's residents without making bricks-and-mortar investments in the state. This Court has been at least as concerned about state efforts to influence these decisions and developments as it has about protection of simpler forms of in-state interests.

Kentucky does not deny that the law has evolved over time and does not argue that Petitioners are misreading cases like *Boston Exchange*. Its only response to this line of cases is that "Kentucky's law does not encourage economic activity in Kentucky." Opp. 12. Kentucky made the same argument below, and the Court of Appeals did not embrace it because it was so clearly incorrect. The complaint alleges (and Kentucky

cannot dispute at this juncture) that Kentucky's new statutory structure boosted cable's competitive position in relation to its satellite competitor. Kentucky does not dispute that cable inherently involves significantly greater in-state economic activity than satellite. The end result, then, is that Kentucky's new tax structure rewards the business that entails greater local economic activity and punishes the business that entails less local economic activity. In short, Kentucky's law does, indeed, "encourage economic activity in Kentucky."

Kentucky cannot change this reality by manipulating the "in state" and "out of state" labels, pointing out, for example, that its tax laws do not depend on a company's domicile. *See* Opp. 11, 15-17. As Petitioners have demonstrated, Dormant Commerce Clause jurisprudence no longer depends on the domicile or corporate headquarters of various businesses. *Boston Stock Exchange*, for example, would undoubtedly have come out the same way had the out-of-state exchange been owned by New Yorkers. Moreover, this Court has consistently held that discrimination in favor of the in-state competitors and against the out-of-state competitors is not excused just because the discrimination is less than absolute. *C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 391 (1994); *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 354 n.4 (1951). Nor is Commerce Clause scrutiny defeated, for example, if a favored local electric utility happens to import its coal from another state.

Contrary to Kentucky's assertion, nothing in *Exxon Corp. v. Maryland*, 437 U.S. 117 (1978), affects this case. The Court there held that the

Commerce Clause protects interstate markets, not the structure or methods of operating in a retail market. Opp. 18. *Exxon*, however, is nothing like this case. There, a Maryland law prohibited oil refiners from vertically integrating with gas retailers in the state. That law advanced a particular philosophy of political economy. Under that philosophy, it is better for those producing and refining oil to not have involvement in, ownership of, or control over retail gas stations. Large producers and refiners would have to negotiate contracts with an independent tier of firms within the distribution system to have the outlets necessary for their gas to reach consumers. Those selling gas to consumers would all have the same independence from refiners generally and the same need to contract with a particular refiner for a supply.

Operating in the post-*Lochner* era, this Court held that neither due process, nor antitrust laws, nor the Dormant Commerce Clause precluded Maryland from adopting this structural approach to competition, this philosophy of political economy. *Exxon*, 437 U.S. at 124-34. Maryland's vertical segregation of the distribution of gas, this Court held, was not a Dormant Commerce Clause violation just because the disadvantaged oil refiners all happened to be out-of-state. In fact, that meant that there were no favored in-state refiners. *Id.* at 125. At the producer and refiner level of distribution, there was no discrimination among firms based on the extent of their investments in or activities within the state. Thus, the net effect of the restructuring was that some businesses might "shift from one interstate supplier to another." *Id.* at 125, 127. But that shift

would not be toward a refiner that had a heavier footprint in the state or that otherwise occupied a favored position within the state.

The fact that many of the independent retailers who benefited from the segregation of refiners from retail markets were owned by state residents was equally irrelevant to this Court. There was no discrimination at the retail segment of the segregated distribution chain either. Nothing prevented out-of-state, independent retail chains from entering the state and competing with the in-state retailers who benefited from the law. *Id.* at 125-26. Simply put, particular independent retailers did not benefit to the extent that they were owned by in-state interests or otherwise favored by the state.

Here, in contrast, Kentucky has not acted in a non-discriminatory manner to advance a new philosophy of political economy that strikes at vertical integration in the production and delivery of video programming. Rather, Kentucky acted to favor one competitor over another within the same segment of the market. Its favored competitor has an inherent dependence on local investment and activity. Unlike the disadvantaged oil refiners in *Exxon*, Petitioners can point to horizontal competitors that are favored because of their in-state activities. Unlike the favored independent retailers in *Exxon*, cable distributors benefit because of their relatively heavy in-state footprint. The discrimination here, unlike the discrimination in *Exxon*, will certainly "cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market." *Id.* at 126 n.16. Nor can

it be said here that non-integrated out-of-state retailers are unaffected by the law—the satellite providers are non-integrated out-of-state retailers.

IV. KENTUCKY'S TAX LAW DISCRIMINATES IN FAVOR OF CABLE AND AGAINST SATELLITE.

Beyond offering an erroneous conception of what it means to discriminate against interstate commerce, which the Court of Appeals did not adopt, Kentucky has precious little to say in defense of the rationale the Court of Appeals did adopt.

Kentucky argues that there is no discrimination because Kentucky's law imposes the same tax rate on both cable and satellite. Opp. 11. That was true of the state law that this Court struck in *West Lynn Creamery*. But of course, this Court has long recognized that even a uniform tax can be impermissibly discriminatory if integrated with a discriminatory subsidy. Thus, this argument does not get Kentucky anywhere, unless it can demonstrate that the subsidy—the payment of franchise fees on behalf of cable—is non-discriminatory.

On this point, Kentucky responds that there is no discriminatory subsidy, because Kentucky has merely abolished cable franchise fees, which it was under "no legal requirement" to maintain. Opp. 19. The complaint, however, alleges—and Kentucky cannot at this juncture deny—that the practical effect of the Kentucky law was not to abolish the franchise fees. Pet. 7-9, 30-31.

Kentucky acknowledges that courts must look beyond formalism and assess the net practical

effect of the scheme. Pet. 20. But it does not refute any of the reasons Petitioners have recited for why this integrated scheme is not, and cannot be treated as, a simple repeal of franchise fees. First, *pace* Kentucky's portrayal of them as taxes, franchise fees are costs that cable companies pay in return for real economic benefits. Pet. 3-4, 31 & n.6. The Sixth Circuit assumed that fact, as it had to. Second, as a practical matter, Kentucky has retained franchise fees, but merely acts as the collection agent for the municipalities—so that now the state collects equivalent payments and transfers them directly to the local governments. Pet. 7-9, 30-31. Third, Kentucky neutralized any opposition from local governments by replacing the franchise fees with equivalent (or greater) revenue from the same sources. Kentucky preserved for local governments in substance exactly what it took away in name. Pet. 8-9, 30. In short, as an economic matter and a political matter, franchise fees remain in effect.

Kentucky asserts that Petitioners are simply trying to "preserv[e] an advantageous position they enjoyed under prior state law in tandem with federal law," which prohibits local governments from imposing franchise fees on cable. Opp. 22. It seems to blame the discriminatory effect on federal law. *Id.* In so arguing, however, Kentucky seems to ignore the obvious point that the reason Congress prohibited local governments from collecting franchise fees from satellite companies was that these companies do not dig up public streets or hang wires on local utility poles. The discrimination here consists of Kentucky's decision to pay on cable's behalf a cost that cable alone incurs, and that, for good reason, local

governments cannot legally impose on satellite providers. It is the Kentucky law that discriminates, and it is the Kentucky law that must be struck.

CONCLUSION

For these reasons, the Court should grant the Petition.

Respectfully submitted,

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